

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Nakano Analyst: Darrine Distefano Bill Number: AB 2926
Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: 02-20-2004
Attorney: Patrick Kusiak Sponsor: California Credits Group

SUBJECT: Employer Hiring Credit/Wages Paid To Enterprise Zone, LAMBRA, & TTA
Employees/Certification May Be From Enterprise Zone & LAMBRA Vouchering
Coordinator or Targeted Tax Area Coordinator

SUMMARY

This bill would revise and expand the qualifying process for the hiring credit in economic development areas (EDAs).

PURPOSE OF THE BILL

According to the sponsor, the purpose of this bill is to decrease the state's authority over the vouchering process and expand the law to include other entities that also have expertise with the vouchering process in the EDA.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2005, and operative on and after that date.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is currently working with the author's staff in resolving the implementation and policy considerations discussed below.

ANALYSIS

STATE LAW

Under existing state law, taxpayers operating in an EDA are allowed a hiring credit for employing "qualified employees." "Qualified employees" for all EDAs generally are defined by reference to various state and federal public assistance programs. EDAs include Enterprise Zones (EZ), Local Agency Military Base Recovery Areas (LAMBRA), Manufacturing Enhancement Areas (MEA), and Targeted Tax Areas (TTA). As of January 2004, the Department of Housing and Community Development (DHCD) assumed responsibility for administering the EDA program.

Existing EZ, LAMBRA, and TTA statutes require taxpayers claiming a hiring credit to obtain a voucher certificate. The voucher certificate is issued by a local (within the same EDA as the workplace of the employee) federal or state agency familiar with the public assistance statutes and indicates that the employee is qualified for or receiving any of the specified forms of public assistance and thus is a "qualified employee."

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Will Bush for Gerald H. Goldberg

5/3/04

THIS BILL

This bill would add the following terms to the list of eligible vouchering agents from which an employer may obtain employee certification: "any Targeted Tax Area coordinator," "any LAMBRA vouchering coordinator," and "any Enterprise Zone vouchering coordinator."

This bill would provide that the hiring credit would not apply to wages paid after a qualified taxpayer has received notice that the certification of a qualified employee has been revoked or if the state determines the certification was issued in error. This bill would change present law to allow employers to retain credits claimed with respect to wages paid to employees for whom the employers improperly received certification.

IMPLEMENTATION CONSIDERATIONS

This bill adds the terms "**any** Targeted Tax Area coordinator," "**any** Enterprise Zone vouchering coordinator," and "**any** LAMBRA vouchering coordinator." These terms are not defined. According to the sponsor, these terms are to include other entities that are already issuing vouchers to employers. However, the use of the word "any" may cause confusion for the taxpayer and the department since it expands the class of eligible vouchering agents beyond who is currently identified in the Revenue & Taxation Code (R&TC).

This bill allows employers to retain previously claimed credits if a voucher "has been revoked by the issuing agency or determined to be issued in error by the state." However, this bill does not identify who is intended to be "the state" for purposes of this revocation provision (DHCD, Franchise Tax Board (FTB), etc.), so it is unclear which state agency or agencies could in fact revoke a voucher.

This bill fails to provide any revocation standard. It is unclear what the basis is for a voucher to be revoked such as, fraud, incomplete information, or an inadvertent mistake. Most credits, including the EDA hiring credit, require recapture of the claimed credit if either the taxpayer's actions or use of the qualified item has changed to a non-qualified use or behavior. Under this bill, if the voucher was erroneously issued, for whatever reason, the bill simply states that the taxpayer is not entitled to credit for wages paid after receiving notice of the revocation. Of the total amount of EDA hiring credit that might be claimed with respect to a particular employee over five years, the majority of the economic value of those credits resides in the first three years. Consequently, even if an employer were notified that the employee had been improperly certified, the employer would be able to claim and retain the bulk of the potential EDA hiring credits, even though claimed with respect to an unqualified employee. Appropriate tax policy would seem to dictate that the voucher should similarly be deemed invalid when issued (rather than the date of revocation). The language seems to indicate intent for taxpayers to be allowed the credit for the period prior to revocation, even if the voucher was obtained fraudulently. This conclusion, if valid, might raise the issue of whether the bill constitutes a gift of public funds.

LEGISLATIVE HISTORY

AB 2895 (Ch. 864, Stat. 2000) amended the LAMBRA and the MEA hiring credit statutes to be consistent with the existing EZ and TTA statutes. Taxpayers are required to obtain a voucher for each newly hired employee, except with regards to the MEA hiring credit. No certification is required to claim the MEA hiring credit.

PROGRAM BACKGROUND

The vouchering process serves numerous functions for all parties affected, including the taxpayer, FTB, and DCHD, such as:

1. Allows DCHD to track the number of employees hired for which the hiring credit is claimed, thus facilitating evaluation of the individual program's effectiveness and ability to provide annual reports to the Legislature.
2. Provides an up-front verification process for taxpayers regarding the determination of whether a potential employee is a "qualified employee."
3. Minimizes intrusiveness into the employee's personal life and provides confidentiality for the employee since the agency that administers the public assistance program is the one that issues the voucher.
4. Allows the employer (taxpayer) to retain less documentation to support a claim that an employee is a "qualified employee."
5. Promotes consistency in application of the definition of a "qualified employee" under the public assistance statutes and the EDA statutes by requiring those most familiar with (and responsible for administering) the public assistance statutes to determine whether a potential employee is a "qualified employee."
6. Allows FTB to verify an employee's eligibility if the hiring credit is reviewed during an FTB audit examination.
7. Allows both FTB and DHCD to verify that the credit is limited to individuals and businesses that qualify for the credit as the Legislature intended.

OTHER STATES' INFORMATION

Since this bill is revising the vouchering process specifically for California EDAs, a comparison to the tax laws of other states would not be meaningful for this bill.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be minor. The additional costs have not been determined at this time. If the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested if necessary.

ECONOMIC IMPACT

Revenue Estimate

Revenue Impact of AB 2926 Assumed Effective 1/1/04 and Enactment after 9/1/04 (\$ In Millions)			
Fiscal Year	2004/05	2005/06	2006/07
Revenue Losses	-\$3	-\$11	-\$17

Revenue Discussion

The revenue impact of this bill would depend on the number of vouchers issued beyond those that would have been issued under current law. Based on current law, the projected amount of new hiring credits for taxpayers that operate a business in an EDA would rise from \$70 million in 2004 to \$85 million by 2006. However, a number of EZs will have expired by 2007, resulting in a projected drop in new hiring credits to \$70 million. Since a new designation can be made upon the expiration of an EZ, it is assumed the revenue impact after 2007 would be minimal due to a gradual use of the hiring credit within the newly designated area over initial years.

Based on presumed enactment date after 9/1/04, it is projected this bill would generate a 5% increase in volume, amounting to \$3 million more than projected losses of \$70 million for fiscal year 2004/05. For fiscal years 2005/06 and 2006/07, taxpayer awareness will have reached sufficient capacity, considering that interest in this bill is assumed to be already at a high level. Private zone consultants would likely solicit requests from taxpayers who may not have initiated such a claim by their own choice. Therefore, it is estimated that a 15% increase in volume would occur in 2005/06 and a 20% increase in volume would occur in 2006/07. This increase in volume is substantially based on a recent trend toward retroactive vouchering that allows hiring credits to be generated for current and prior years. It is expected this trend would become more prominent from the flexibility created by this bill, resulting in additional revenue losses of \$11 million over the \$75 million current law projections 2005/06 and \$17 million over \$85 million current law projections for 2006/07.

POLICY CONCERNS

According to the sponsor, the current language in AB 2926 is based on provisions taken from Unemployment Code (UC) Section 328 and R&TC Sections 17053.7 and 23621, which contain provisions for the former jobs tax credit. However, those sections of the UC and R&TC are no longer operative. Moreover, there are significant differences between the jobs tax credit and the EDA hiring credit as illustrated in the table below:

Jobs Tax Credit – California¹	EDA Hiring Credit
• Credit claimed for 2-year period	• Credit claimed for 5-year period
• Maximum per employee credit of \$600	• Maximum per employee credit of \$33,000 ²
• Voucher issued by single agency authorized by statute	• Voucher issued by various agencies
• Voucher issued prior to or at the time of hire	• Voucher issued at any time after hire
• Criteria for certification generally required enrollment in various public assistance programs	• Criteria for certification based on eligibility for , or actual enrollment in, public assistance programs, or in certain situations residency.

¹ The California jobs tax credit under former law substantially conformed to the federal jobs tax credit, except for the amount of the credit.

² Estimated based on standard workweek of 40 hours. Credit is based on hours worked.

Under the prior jobs tax credit, the taxpayer was not allowed to claim the credit from the date a notice of revocation was received. The Employment Development Department (EDD) was the central agency responsible for certifying and issuing the certificate prior to the time of hire. If an employee provided false information to EDD, a notice of revocation was sent to the employer from EDD. Since the employer took the appropriate steps to correctly obtain a certificate and it was the employee who provided false information to EDD, the legislative policy decision in that statute provided that the employer could retain the credit. In marked contrast, EDA vouchers are not issued by a centralized agency nor required to be obtained at or prior to the commencement of employment. Many employees are also not involved in the voucher process or asked by their employer to confirm or verify their eligibility under the credit. Therefore, use of the revocation language from the jobs tax credit may not be appropriate.

Allowing the credit to taxpayers who have inappropriately obtained a voucher up to the date of notification of revocation significantly alters the relevance of a voucher. Under existing EDA program, vouchers could be issued two to four years after the employee commences work for the employer. If revocation occurs one day after issuance, the bill implicitly suggests that the voucher is valid for the time period prior to revocation (in this example a number of years, resulting in the taxpayer capturing the majority of the credit). If the credit is to be allowed, up to the point another state agency determines the voucher was inappropriately issued, then the checks and balances that should exist between the vouchering agent and DHCD to ensure that the EDA program accomplishes its goals are compromised, perhaps significantly.

Allowing the credit for the period prior to revocation also creates the following inconsistencies:

- Current state law requires FTB to determine the correct amount of tax. In all audits conducted by FTB, if a taxpayer has incorrectly claimed a credit or deduction amount, the credit or deduction is denied until documentation is provided to justify the amount claimed. Allowing the EDA hiring credit, either explicitly or implicitly, for any period for which the voucher was invalid as a result of being inappropriately issued conflicts with this longstanding tax policy.
- Allowing the credit to taxpayers who inappropriately obtained a voucher provides differing treatment against those taxpayers who were denied during the vouchering process and accordingly did not claim the credit

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